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# **Cost Proposals and DCAA Preaward Surveys**

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# **DEFENSE CONTRACT AUDIT AGENCY**

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## **OBJECTIVE**

**To discuss Cost Proposal requirements and Preaward policies contained in FAR/DFARS and explain DCAA's role in each.**



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# **DEFENSE CONTRACT AUDIT AGENCY**

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## **AGENDA**

- **Basics about Defense Contract Audit Agency**
- **Preaward Survey Policies - FAR/DFAR**
- **Financial Condition / Capability**
- **Preaward Accounting Systems**



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# Department of Defense (DoD) Organization

Secretary of Defense  
Deputy Sec of Defense

Department of Army    Department of Navy    Department of Air Force & L (Comptroller)    Under Secretary of Defense    Under Secretary of Defense    I G

Procurement    Procurement    Procurement    DCMA    DCAA



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# **DEFENSE CONTRACT AUDIT AGENCY**

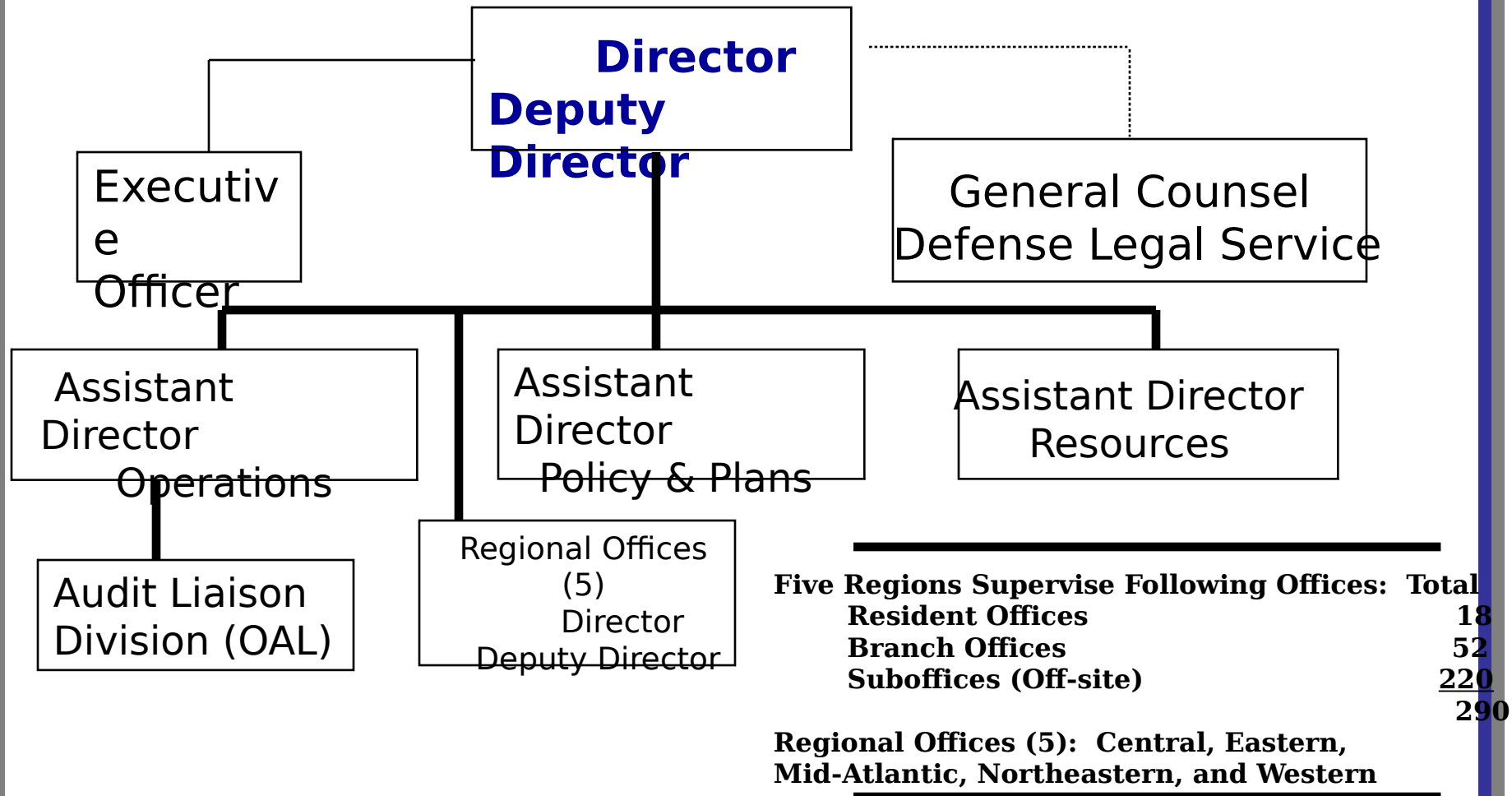
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- **Established in 1965**
- **Separate Agency of the DoD**
- **Reports to DoD Comptroller**
- **Provides Services to All DoD Components**
- **Provides All Contract Audits for DoD**
- **Provides Accounting and Financial Advisory Services for DoD and Non-DoD customers**
- **Over 320 Field Audit and Sub Offices**



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# DCAA ORGANIZATION





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# DCAA FLAs vs. Auditors

## FLA

- On-Site with Customer
- Available for immediate advice on cost/pricing data and audit/financial issues
- Facilitate audits/services

## Field Auditor

- On-Site at contractor location
- Has access to contractor's books and records (*original source documents – not copies*)
- Performs audits/engagements
- Issues DCAA reports
- Gives opinions



# DCAA Services

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***DCAA performs more than 80 different types of audit services***





# **DCAA Services - *DRAFT***

## ***Preaward Review Types***

- **Price Proposals**
  - **Fixed Price > \$650K (DFARS 215.404-2)**
  - **Cost Type > \$10M (DFARS 215.404-2)**
- **Accounting System**
- **Financial Condition/Capability**

***Primarily PCO  
Requested***





- Home
- ▼ About DCAA
- ▼ Audit Guidance
  - Audit Office Locator
  - Career Center
  - Directions/Map
  - EEO Data (No Fear Act)
  - FOIA
  - Links to Other Sites
  - Points of Contact
  - Privacy Act
- ▼ Publications
  - Catalog of Courses
  - Contract Audit Manual
  - Directory of DCAA Offi
  - EZ-Quant
  - FAR Cost Principles G
  - Incurred Cost Electron
  - Info for Contractors

Bookmarks

Layers

Pages

Attachments

Comments

Options x

- [-] DCAAP 7641.90 - Information for Contractors
  - [-] Foreword
  - [-] Notes on Substantive Changes
  - [-] Table of Contents
  - [+] Chapter 1 - Introduction to the Defense
  - [+] Chapter 2 - Preaward Surveys of Prospective
  - [+] Chapter 3 - Price Proposals
  - [+] Chapter 4 - Cost Accounting Standards
  - [+] Chapter 5 - Contract Financing and Inter
  - [+] Chapter 6 - Incurred Cost Proposals
  - [+] Chapter 7 - Contract Types
  - [+] Chapter 8 - Forms
  - [+] Appendix A - List of Acronyms and Abb
  - [+] Appendix B - FAR Subpart 4.7 - Contrac

**DCAAP 7641.90**  
**January 2005**

## INFORMATION FOR CONTRACTORS





# FAR 15.402

## *Pricing Policy*

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FAR 15.402 - *Pricing Policy* states:

“Contracting Officers shall --

(a) Purchase supplies and services from **responsible sources** at **fair and reasonable prices**...”

- **Responsible Sources – FAR 9.1**
- **Fair and Reasonable Prices – FAR 15.402**



# FAR 9.103

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## ***Responsible Contractors***

FAR 9.103 – *Responsible Contractors* states:

“Purchases shall be made from, and contracts shall be awarded to, **responsible prospective contractors** only.”



# **FAR and DFARS** *DRAFT*

## *Key References*

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- **9.104** Responsibility Standards
  - **9.104-1** General Standards
  - **209.104-1** General Standards
  - **9.104-3** Application of Standards
  - **9.104-4** Subcontractor Responsibility
- **9.105** Obtaining Information
- **232.072** Financial Responsibility of Contractors
- **242.7501** Accounting System and Controls



# FAR 9.104-1 *DRAFT*

## *General Standards*

- FAR 9.104-1 – “**Prospective Contractor must:**”
  - a) Have **adequate financial resources**
  - b) comply with required delivery/performance schedule
  - c) Have a satisfactory performance record
  - d) Have satisfactory record of integrity/business ethics
  - e) Have the necessary organization, experience, **accounting and operational controls**, and technical skills...
  - f) Have the necessary equipment...



# DFARS 209.104-1 *DRAFT*

## 242.7501

### *General Standards*

- DFARS 209.104-1(e) & 242.7501 – Applicable to:
    - **Cost-Reimbursement or Incentive type contracts**
    - **Contracts billed using progress payments**
- “... prospective **contractor’s accounting system** and related internal controls must provide reasonable assurance that—
- (i) Applicable laws and regulations are complied with;
  - (ii) The accounting system and cost data are reliable;
  - (iii) Risk of misallocations and mischarges are minimized; and
  - (iv) Contract allocations and charges are consistent with



# FAR 9.104-3

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## *Applying the Standards*

- FAR 9.104-3 – **Application of Standards**
  - a) **Ability to obtain resources** – includes financial resources, accounting controls, technical skills, and equipment
  - b) Satisfactory performance record
  - c) “Affiliated concerns” (ie, related parties)
  - d) Small business concerns
    - 1) If found non-responsible, may be referred to SBA to obtain a Certificate of Competency (COC)
    - 2) May be found non-responsible if unable to comply with subcontracting limitations in FAR 52.219-14 (ie, 50% rule)





# FAR 9.104-4

## *Subcontractors*

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- FAR 9.104-4 – **Subcontractor Responsibility**
  - a) Generally, prime contractor determines subcontractor responsibility and may be required to show evidence of responsibility
  - b) Gov't may directly determine subcontractor responsibility:
    - 1) When contract involves medical supplies
    - 2) When contract involves urgent



# FAR 9.105

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## ***Obtaining Information***

- FAR 9.105-1(b)(1) – **Obtaining Information**

“Generally, the contracting officer shall obtain information regarding the responsibility of prospective contractors, including requesting preaward surveys when necessary, promptly after a **bid opening** or receipt of offers.

**However**, in **negotiated contracting**, especially when research and development is involved, the contracting officer may obtain this information **before issuing the request for proposals.**”



# FAR 9.105

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## *Obtaining Information*

- FAR 9.105-1(b)(2)(ii) – **Obtaining Information**

“...the contracting officer shall obtain from the auditor any information required concerning prospective contractors' financial competence and credit needs, the adequacy of their accounting systems, and these systems' suitability for use in administering the proposed type of contract .”



# FAR 19.6 & 19.8 <sup>DRAFT</sup>

## *Small Businesses & 8(a)*

- Small Businesses are exempt from the 19 Cost Accounting Standards (CAS) per 48 CFR 99
- However, small businesses are **not** exempt from:
  - Accounting for their costs on cost-type contracts
  - Maintaining adequate financial resources to perform
- PCOs should still request Preaward Survey
- If small business does not meet FAR Part 9.1, they may apply for SBA Certificate of Competency (COC)



**FAR 1.102-4(e)** *DRAFT*

# ***Role of the Acquisition Team***

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## **(FAR Part 1.102-4(e))**

**“...If a policy or procedure, or a particular strategy or practice, is in the best interest of the Government & is not specifically addressed in the FAR, nor prohibited ... the Team should not assume it is prohibited. Rather, absence of direction should be interpreted as permitting the Team to innovate & use **sound business judgment** that is otherwise **consistent with law** & within the limits of their authority.”**



# DCAA Services - *DRAFT*

## *Preaward Surveys*

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- **Financial Capability** reviews (DCAA code 17600)
- **Accounting System** reviews (DCAA code 17740)
- Customer can request these reviews **BEFORE** obtaining proposals from the contractors



# DCAA Services<sup>DRAFT</sup>

## *Preaward Surveys* - BEST PRACTICES

### **Suggested sequence of steps during source selection:**

- **Prospective offerors who intend to bid indicate readiness for DCAA *Accounting System and Financial Condition* reviews 2-3 months prior to the date proposals will be due:**
- **DCAA/Contractor/PCO works to resolve findings**
- **Offerors subsequently submit proposals**
- **Customer evaluates price/cost &**



# DCAA Services - *DRAFT*

## *Financial*

## *Condition/Capability*

- Financial Condition Risk Assessment - focuses on current condition based on existing financial data, **past** trends, ratios
  - Performed **annually**
- Financial Capability Audit - focuses on contractor's **future** capabilities to perform contracts based on projected business, future cash flows, lines of credit to sustain them, etc
  - Performed if Financial Condition Risk Assessment **reveals problems**



# DETAILED RISK ASSESSMENT AND AUDIT

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## SUMMARY OF POTENTIAL CONSIDERATIONS

### FINANCIAL CONDITION

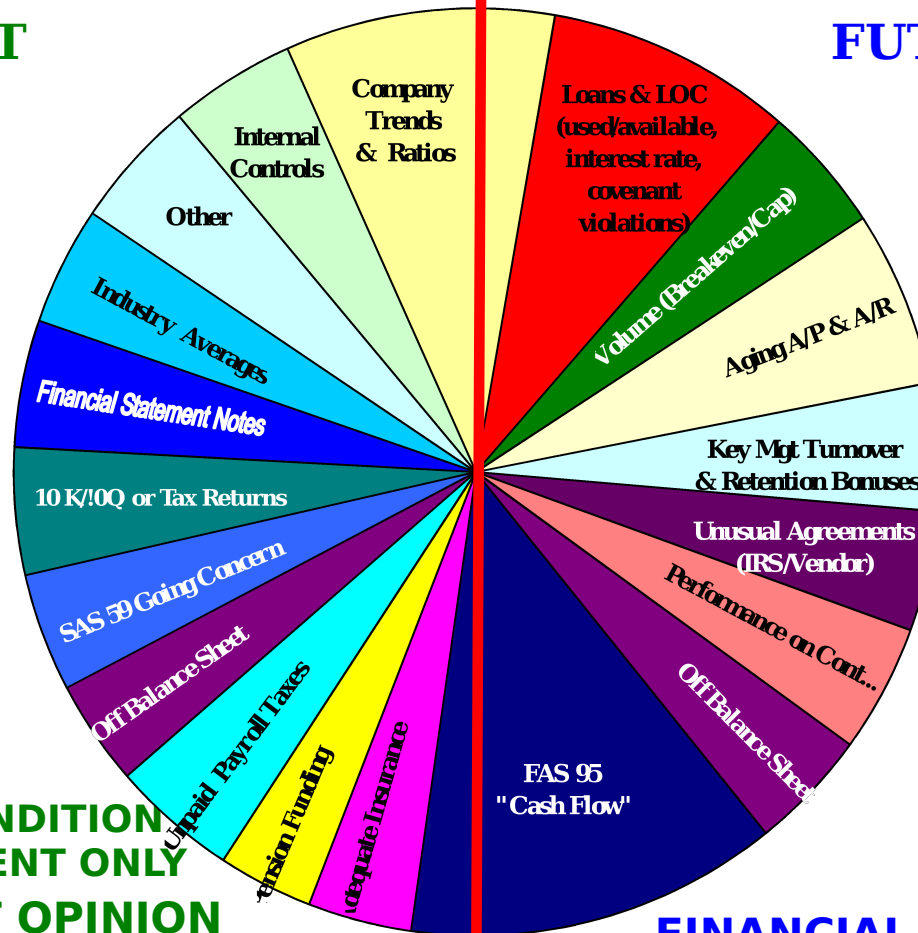
Historical data which represents a snapshot at a point in time.

### FINANCIAL CAPABILITY

Prospective data based on current and near term.

**PAST**

**FUTURE**



**FINANCIAL CONDITION  
RISK ASSESSMENT ONLY  
NO AUDIT OPINION**

**FINANCIAL CAPABILITY  
AUDIT  
AUDIT OPINION based both on  
Risk Assessment and Audit**



# RFP Items to Request - *Financial Condition*

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At a minimum RFP should request offerors:

- Identify significant related parties / extent of parent control
  - Request financial data for Parent co. if they control cash/credit
  - Suggest corporate guarantee when Parent controls cash/credit
- Three to Five (3-5) years of financial statements to include
  - Audited, Reviewed, Compiled or Certified Financial Stmts
  - Balance sheet, Income Statement, and Cash Flow Statement
  - Notes / disclosures to financial stmts; explain



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# **Key Financial Condition Steps**

- Compute several **Key Financial Ratios**
- **Benchmark** Key Financial Ratios to Industry
- Evaluate **Trends** over a **3+ year** period
- Go Beyond Metrics & evaluate stress points:
  - Unpaid Payroll Taxes
  - Pension Funding
  - Inadequate Insurance
  - Note and Disclosures with regards to:
    - Internal Control Issues
    - Related Party Interests, Organizational Changes, etc



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# Key Financial Ratios

Ratio	Formula
Current Ratio	$\text{Current Assets} / \text{Current Liabilities}$
Acid Test (Quick Ratio)	$\text{Liquid Assets} / \text{Current Liabilities}$
Return on Investment	$\text{Net Income} / \text{Total Assets}$
Debt to Equity	$\text{Total Debt} / \text{Stockholder's Equity}$
X1 (Per Altman Model)	$\text{Working Capital} / \text{Total Assets}$
Cash Flow to Debt	$\text{Cash Flow} / \text{Total Debt}$



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# Benchmarking Key Ratios

- We use a market survey service called **Compustat**
- Industry codes based on NAICS or

NAICS Code	SIC Code	Industry	Description
236115	1531	General Contractors	New Single Family Housing Construction (except Operative Builders)
236117	1531	Operative Builders	New Housing Operative Builders
236118	1531	Remodeling Contractors	Residential Remodelers
236220	1531	Barrack & Dorm Construction	Commercial and Institutional Building Construction



# **Key Financial Capability Steps**

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- **Evaluate near term Cash Flows**
  - Budgets, forecasts, projections, workload volume
- **Evaluate near term Sources & Uses**
  - A/P & A/R Agings
  - Loans & Lines of Credit - debt schedules
  - New contracts or backlog
  - Acquisitions planned



# DCAA Services - *DRAFT*

## *Preaward Accounting System (17740)*

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- Financial Accounting System is NOT the same thing as Cost Accounting System
- Financial Accounting (eg, a P&L statement) will only report total amounts incurred for each cost element (labor, materials, etc) at company wide level
- Cost Accounting System distributes and allocates those costs among specific contracts, jobs or other cost objectives in causal/beneficial relationships



# DCAA Services - *DRAFT*

## *Preaward Accounting System (17740)*

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- FAR 9.104-1(f), DFARS 209.104-1(e) and 232.072
- Audit is recommended for flexibly priced prime contracts (eg, CPFF, T&M, LH, etc)
- Preaward Accounting System Audit and SF1408 - focuses on contractor's ability to:
  - allocate costs among contracts and CLINs in logical manner
  - exclude unallowable costs
  - record employee labor hours by contract





# **Best Practices** - *Preaward Reviews*

- Request **Electronic Data** in the RFP
- Request Accounting System and Financial Capability Reviews **before** proposal receipt
- Have offeror identify **location of accounting records** for parent / subsidiary company



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# **What is a cost proposal or ~~submission?~~**

**A BREAKDOWN OF COST BY COST  
ELEMENT REPRESENTING COSTS  
THAT WERE ALREADY INCURRED  
(SUBMISSION) OR ARE ESTIMATED  
TO BE INCURRED IN THE FUTURE  
(PROPOSAL)**



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# **GENERAL INFORMATION**

## **ADEQUATE COST**

### **PROPOSALS**

- **By submitting cost proposals you grant the contracting officer the right to examine records that formed the basis for the pricing proposal**
- **The examination can take place any time before award**
- **The examination may include books, records, documents, electronic files & other types of factual information that will permit adequate proposal evaluation**



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# **Typical Problems found in Proposals**

- **Failure to conform to the specifications of the request for proposal**
- **Proposal not mathematically correct**
- **Unallowable cost included in proposal (far 31.205)**
- **Supporting schedules do not tie into summary**
- **Lack of coordination between company departments**
- **Poor or no index of cost & pricing data**
- **Lack of support for SCA or DB wages above wage determination level**
- **No support for indirect expenses &/or improper**



# WHAT IS AN ADEQUATE COST PROPOSAL?

- ✍ **Completed cover letter**
- ✍ **Proposal index**
- ✍ **Identification of cost & pricing data**
- ✍ **Access to records**
- ✍ **Materials**
  - ❶ **Priced bill of materials**
    - **Scrap/material inspection**
    - **Subcontracts**
    - **Interorganizational transfers**



# WHAT IS AN ADEQUATE COST PROPOSAL?

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**THE 1st PAGE OF THE PROPOSAL MUST CONTAIN THE FOLLOWING INFO:**

- (1) Solicitation, contract, and/or modification number;**
- (2) Name and address of offeror;**
- (3) Name and telephone number of point of contact;**
- (4) Name of contract administration office (if available);**
- (5) Type of contract action (that is, new contract, change order, price revision/redetermination, letter contract, unpriced order, or other);**
- (6) Proposed cost; profit or fee; and total;**
- (7) Whether you will require the use of Govt property in the performance of the**



# WHAT IS AN ADEQUATE COST PROPOSAL?

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**THE 1st PAGE OF THE PROPOSAL MUST CONTAIN THE FOLLOWING INFO:**

- (9) The following statement: *This proposal reflects our estimates and/or actual costs as of this date and conforms with the instructions in FAR 15.403-5(b)(1) and Table 15-2. By submitting this proposal, we grant the Contracting Officer and authorized representative(s) the right to examine, at any time before award, those records, which include books, documents, accounting procedures and practices, and other data, regardless of type and form or whether such supporting information is specifically referenced or included in the proposal as the basis for pricing, that will permit an adequate evaluation of the proposed price.***
- (10) Date of submission; and**
- (11) Name, title and signature of authorized**



# WHAT IS AN ADEQUATE COST PROPOSAL

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## **Direct labor**

- **Basis for estimate of labor hrs (actual/engr est)**
- **Basis for labor rates**
- **escalation factors (if proposed) (DRI/BLS)**



## **Indirect costs**

- **Clear explanation of rate development**
- **List of expenses comprising the pool**
- **Is the selection of base equitable?**
- **Do pool & base costs reflect known facts?**



## **Other direct costs**





# **WHAT TO EXPECT - DCAA**

## **AUDIT PROCESS**

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- ➔ Auditor will review proposal for adequacy
- ➔ Auditor will establish mutually acceptable date for audit to begin
- ➔ Auditor will conduct entrance conference
- ➔ Auditor will review the proposal using generally accepted government auditing standards (GAGAS)
- ➔ Auditor will conduct exit conference
- ➔ Auditor will issue audit report to the contracting officer
- ➔ Contractor generally must request copy of



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# Questions?



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